No. 276.

In the Supreme Court of the United States.

OCTOBER TERM, 1923.

WILLIAM H. EDWARDS, FORMERLY COLLECTOR OF INTERNAL REVENUE FOR THE SECOND DISTRICT OF NEW YORK, PETITIONER,

v.

JOSEPH GERMAIN SLOCUM, HERBERT GERMAIN SLOCUM, STEPHEN L'HOMMEDIEU SLOCUM, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE PETITIONER.

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By this writ of certiorari the petitioner, collector of internal revenue, seeks review of a judgment of the Circuit Court of Appeals for the Second Circuit affirming a judgment of the District Court for the Southern District of New York in favor of the respondents against the collector for $412,366.42, together with interest, which amount represents, as found by that court, an overpayment of estate taxes assessed upon the estate of Margaret Olivia Sage, deceased.

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STATEMENT.

The respondents are executors of the will of Mrs. Sage, who died on November 4, 1918, a resident of the City of New York, leaving a will by which she disposed of an estate of about $49,000,000. By this will, after providing for the payment of debts, she made certain pecuniary and specific legacies with directions that the same should be paid free from all legacy or inheritance taxes, and divided the residue into a certain number of equal parts and bequeathed to each of 35 charitable and educational institutions, for charitable, public, and similar purposes, one or more of such equal parts. The effect was to bequeath her entire residuary estate to these institutions. The executors duly filed with the collector a return and paid to the collector the sum of $1,406,865.07, being the amount of the estate tax due and payable upon the basis of said return.

Subsequently the Commissioner of Internal Revenue assessed an additional estate tax of $525,914.22 upon the estate, which was paid under protest (p. 3). Thereafter claim for refund to the extent of $525,801.79 was filed and rejected by the Commissioner. After this action was brought, the collector consented to the entry of judgment in favor of the executors in the sum of $112,172.17, leaving a balance of $413,629.62, the amount of the recovery now sought in this action. The facts were not in dispute, so the collector moved for judgment, dismissing the complaint upon the ground that it did not state facts

sufficient to constitute a cause of action. This motion was denied, with leave to the collector to answer within ten days. The collector did not answer, and final judgment for the amount claimed, with a slight and immaterial deduction, was entered. That judgment was affirmed by the Circuit Court of Appeals, and its judgment now comes before this court for review.

QUESTION INVOLVED.

The question involved is whether, in computing a residuary estate, the amount of the Federal estate tax should first be deducted. The Government claims that it should; the executors that it should not.

The executors computed the value of the residuary estate by deducting from the gross estate the amount of the general legacies, debts, administrative expenses, and other charges, without reference to estate taxes. The Commissioner of Internal Revenue recomputed the amount of the residuary estate by subtracting therefrom the amount of such taxes. The specific question is, Which form of computation was correct under the law?

Disregarding all inheritance, legacy, transfer, or estate taxes, the facts about the property passing under this will were as follows:

Debts and expenses	$3,789,321.74
Pecuniary legacies for charitable purposes	1,285,000.00
Pecuniary legacies for noncharitable purposes	8,618,079.55
Remainder, called "residuary"	35,436,855.70
Total	49,129,256.99

The net estate subject to tax, as stated by the executors, was as follows (pp. 4, 5, 6, and 32):

Gross estate		$49,129,256.99
Deductions:		
(1) Debts and administrative expenses	$3,789,321.74	
(2) Charitable legacies other than residual	1,285,000.00	
(3) Residuary for charity	35,436,855.70	
(4) Specific exemption	50,000.00	
		40,561,177.44
Net estate		8,568,079.55

This statement shows the residuary estate for charity to be that which was left after deducting from the gross estate the debts, the expenses of administration (other than estate taxes), charitable bequests other than residual, and the specific exemption of $50,000.

The New York inheritance tax on such legacies as the will declared free of tax was $5,741.83. The account as restated by the Commissioner of Internal Revenue adopted all the executors' figures except those for the residuary estate for charity, which he reduced to $33,610,506.75, thereby increasing the net estate by the amount of the reduction, and on investigation this difference is found to be exactly the total of the estate tax assessed, as follows:

Federal estate tax	$1,820,607.12
New York inheritance tax	5,741.83
Total	1,826,348.95

In other words, the executors computed the residuary estate as what was left after providing for everything except estate taxes; the Commissioner regarded the residuary estate as being what was

left after deductions, including the estate taxes, had been made.

Upon the concrete facts shown by these figures the point at issue may again be stated as follows: Is the residuary estate that which is left after taxes are paid or before they are paid?

STATUTES INVOLVED.

Section 201 of the Revenue Act of 1916 (Act of September 8, 1916, ch. 463, 39 Stat. 756) provides in part as follows:

> That a tax * * * equal to the following percentages of the value of the net estate, to be determined as provided in section two hundred and three, is hereby imposed upon the transfer of the net estate of every decedent dying after the passage of this Act, whether a resident or nonresident of the United States; * * *.

This section was amended by Section 300 of the Act of March 3, 1917, ch. 159 (39 Stat. 1000), increasing the rates of tax; and by Section 900 of the Revenue Act of 1917 (Act of October 3, 1917, ch. 63, 40 Stat. 300) additional estate taxes were levied upon the transfer of the estates of decedents dying after the passage thereof. Section 203 of the Revenue Act of 1916 provides in part as follows:

> That for the purpose of the tax the value of the net estate shall be determined—
>
> (a) In the case of a resident, by deducting from the value of the gross estate—
>
> (1) Such amounts for funeral expenses, administration expenses, claims against the

estate, unpaid mortgages, losses incurred dur-
the settlement of the estate arising from fires, storms, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise, support during the settlement of the estate of those dependent upon the decedent, and such other charges against the estate as are allowed by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered; and

(2) An exemption of $50,000.

Section 403 (a) (3) of the Revenue Act of 1918 (Act of February 24, 1919, ch. 18, 40 Stat. 1057) provides:

That for the purpose of the tax the value of the net estate shall be determined—

(a) In the case of a resident, by deducting from the value of the gross estate—

* * * * *

(3) The amount of all bequests, legacies, devises, or gifts, to or for the use of the United States, any State, Territory, any political subdivision thereof, or the District of Columbia, for exclusively public purposes, or to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, or to a trustee or trustees exclusively for such religious, charitable, scientific, liter-

ary, or educational purposes. This deduction shall be made in case of the estates of all decedents who have died since December 31, 1917; * * *.

As Mrs. Sage died on November 4, 1918, this provision applies to her estate.

ARGUMENT.

I.

The residuary estate is that which remains after all paramount claims upon the estate have been satisfied.

Judge Hough, writing for the Circuit Court of Appeals, states very clearly and forcibly certain fundamental and conceded propositions involved in this case as follows (p. 33):

> That this is not an inheritance or legacy tax, that it is not payable by legatees or out of legacies as such, and that it is a tax payable out of and on the estate and by the executors is agreed (Matter of Hamlin, 226 N. Y. 407), and no complaint is now made as to including in whatever is taxed or measures tax the New York inheritance taxes. (*New York &c., Co.* v. *Eisner*, 256 U. S. 345.)
>
> Taxes, however, are not laid on abstractions, names do not change facts, and every tax ultimately falls on some person, unless it be laid upon a thing without an owner, which is rare.
>
> So far as the words of this statute are concerned, the United States does not care who ultimately bears the weight of this tax; it

> announces the sum and demands payment from the executors; if the legatees and devisees cannot agree as to the burden bearing, the State courts can settle the matter. The New York courts have settled it, so far as this estate is concerned, by the Hamlin case (supra), and this tax is payable out of the whole estate as a permanent charge, which in effect casts it on or takes it out of the residuary. That the residuary estate is devoted to charity, &c., makes no difference.

These executors exercise their duties pursuant to the laws of the State of New York, where they were appointed, and will account to the courts of that State in accordance with its law. Under the law of that State the Federal estate tax will be paid out of the residuary estate under the principle laid down by the Court of Appeals of that State in *Matter of Hamlin*, 226 N. Y. 407. Therefore, the amount stated by the executors as the residuary estate which will go to the charitable beneficiaries of Mrs. Sage is not the amount which they will receive. From that amount will be deducted before it reaches the beneficiaries, even if the judgment herein is affirmed, the sum of $1,406,977.50.

The question is whether "the rest, residue, and remainder of my estate," which Mrs. Sage bequeathed to charity, means the amount which will actually be given to them or whether it means the amount which they would receive if there was no Federal tax. It is a question of the meaning of the term "residuary estate," and, as Judge Hough says,

the fact that it is devoted to charity makes no difference.

That the amount of the residuary estate is what is left after the subtraction of all paramount claims is not open to question. It is a term which has been known to the law long before there were any Federal estate taxes. In *Morgan* v. *Huggins*, 48 Fed. 3, at page 5, it is defined as "what is left after all liabilities are discharged and all the objects of the testator are carried into effect." In defining the residue in the case of an estate subject to the Federal estate tax the court said in *Plunkett* v. *Old Colony Trust Company*, 233 Mass. 471, at pages 475 to 476:

> It is the general rule that, failing any testamentary provision to the contrary, debts, charges, and all just obligations upon an estate must be paid out of the residue of an estate. The benefaction conferred by the residuary clause of a will is only of that which remains after all paramount claims upon the estate of the testator are satisfied. *Tomlinson* v. *Bury*, 145 Mass. 346. The tax is a pecuniary burden or imposition laid upon the estate. *Boston* v. *Turner*, 201 Mass. 109-193. In its nature it is superior to the claims of the residuary legatee. Since neither the act of Congress nor the will and codicils make any other provision for the point of ultimate incidence of this tax, it must rest on the residue of the estate. *Matter of Hamlin*, 226 N. Y. 407, 418, 419.

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It is this amount, and this amount only, which, under the statute, is deductible from the gross estate in the case at bar. The residue as computed by the executors is what is left after the fixed legacies, debts, and administration expenses are paid but before the Federal estate tax is paid, a tax which is prior to all charges except possibly administration expenses. It reduces the residue just as surely as do funeral expenses, executors' and attorneys' fees, and debts, and is no more a part of the residue than they are.

The fallacy of contending that the Federal estate tax must not be subtracted in obtaining the amount of the residue left to charities is made evident if we suppose a case where the residuary estate, without diminution by reason of the Federal tax, was less than the tax. In that case the residuary legatees would receive nothing. If that were the situation here, and if the specific and general legacies had been so large that the residuary estate was not equal to the amount of the Federal tax, then not only would the residuary beneficiaries of Mrs. Sage's bounty have received nothing but the other legacies would be reduced by contributions to pay the tax. This would be inevitable in an accounting proceeding by the executors under the authority of *Matter of Hamlin*, 226 N. Y. 407.

The New York courts have held that, under the State transfer tax act, in ascertaining the value of the residuary estate for the purpose of computing

the transfer tax, no reduction can be made for the amount of the Federal estate tax. *Matter of Swift*, 137 N. Y. 77; *Matter of Bierstadt*, 178 App. Div. 836; *Matter of Sherman*, 179 App. Div. 497, affirmed 222 N. Y. 540. That rule has been repeatedly criticized and repudiated by the courts of other jurisdictions and, so far as we have discovered, has been followed in but two states, Wisconsin and Rhode Island. It has been repudiated in other states as follows:

Massachusetts:

Old Colony Trust Company v. *Treasurer, etc.*, 238 Mass. 544. In that case the court said, at page 549:

> The United States estate tax should have been wholly deducted. In its nature such a tax is a charge upon the net estate transferred by death and not upon the succession resulting from death * * *. The estate, upon the death, is to the extent of the tax instantly depleted.

See also *Plunkett* v. *Old Colony Trust Company*, 233 Mass. 471, *supra*.

Connecticut:

In *Corbin* v. *Townshend*, 92 Conn. 501, the court said (pages 505, 506):

> It (the Federal estate tax) is an obligation against the estate and payable like any expense which falls under the head of administration expenses. The tax paid is no part of the estate at the time of distribution; it has passed from the estate and the share of the beneficiaries is diminished by just so much

> * * *. The payment of the Federal tax is an expense of the estate, as much so as any expense of administration.

New Jersey:

In re Roebling's Estate, 89 N. J. Eq. 163. Followed in *In re Kountze's Estate*, 93 N. J. Eq. 143.

Pennsylvania:

In Pennsylvania, before the statute was amended to provide specifically that the Federal estate tax should not be subtracted, it was held that it should be subtracted in computing the Pennsylvania collateral inheritance tax. *In re Knight's Estate*, 261 Pa. 537.

Indiana:

In the case of *State* v. *First Calumet Trust & Savings Bank*, 71 Ind. App. 467, the court said, at page 471:

> The tax paid to the Federal government upon the net estate before distribution can not in any sense be held to have been any part of the beneficial interest of the respective legatees or distributees, and the market value of such beneficial interest must of necessity be the value after deducting the federal tax, the same having been deducted from the net estate before distribution was made thereof, and it necessarily follows that the state inheritance tax should be computed upon the residue after deducting from the net estate the amount of such federal estate tax.

Illinois:

In *People* v. *Pasfield*, 284 Ill. 450, the court said, at page 454:

> The legatees and distributees can not in any sense be held to have "received" any part of the duty that is paid to the Government by the executor * * *. The Federal Estate Tax act of September 8, 1916, necessarily operated to lessen, by the amount of such tax, the clear value of the beneficial interest which passed to the heirs and legatees in the instant case and prevented their receiving any part of that tax, and the ruling of the county court that the same should be deducted before computing the State tax was correct. See also *People* v. *Northern Trust Company*, 289 Ill. 475.

Minnesota:

No case directly involving a residuary estate has been found, but in *State ex rel. Smith* v. *Probate Court of Hennepin County*, 139 Minn. 210, the question arose whether the Federal estate tax should be subtracted from the value of an estate passing by descent before computing the State inheritance tax. The court held that it should be.

Colorado:

People v. *Bemis*, 68 Col. 48.

Oregon:

In *In re Inman's Estate*, 101 Ore. 182, the court said:

> No part of the federal estate tax * * * ever passed, theoretically or actually, to the widow or daughters; for this tax was imposed

> and collected before its distribution, and, like the old probate tax, ought to be deducted from the gross estate just as expenses of administration are deducted (p. 200).

California:

Estate of Miller, 184 Cal. 674.

The following cases are, to some extent, authorities to the contrary:

Estate of Sanford, 188 Iowa 833.

In this case it was held that under the Iowa statute the Federal estate tax could not be subtracted. This decision, however, turned on the wording of the statute of Iowa, which provided that only "debts" could be deducted, and debts were defined by the Iowa code, Section 1471–a2, to include local or state taxes, funeral expenses, court costs, cost of appraisement, fees of executors, administrators, and trustees, premiums on bonds, attorneys' fees, and *no other sum*.

The Rhode Island case of *Hazard* v. *Bliss*, 113 Atl. Rep. 469, 43 Rhode Island, 431, holds that the Rhode Island legacy tax attaches at the time of death, and that if the Federal Government appropriates a portion of the estate, Rhode Island is not bound to recognize this fact for the purpose of reducing its tax. The decision was rendered with two of the five justices dissenting. That the majority opinion did not hold that the Federal estate tax is in fact part of the amount of the residuary bequest, as that term is commonly understood, appears from the following quotations:

> The payment of the federal tax of necessity reduced the value of the residuary estate * * *. (113 Atl. p. 473.)
>
> Such payment (of the Federal estate tax) reduces the amount of the residuary estate. (113 Atl. p. 477.)

The case of *Estate of Week*, 169 Wis. 316, one justice dissenting, squarely followed the New York rule. The court, however, frankly admits the inconsistency of allowing expenses of administration as a deduction and at the same time disallowing the Federal estate tax. The court says, at page 319:

> There may be some difficulty in reconciling this conclusion with the prevailing practice of deducting expenses of administration. We realize that our logic would lead to a rejection of such deductions. We have no disposition, however, to disturb the practice that has uniformly prevailed. We took the practice with the law from New York.

The executors argue that to lessen the residuary estate by the amount of the Federal estate tax is to violate the spirit of the statute which is designed to favor charities. No man would say, however, that the testatrix gave her debts and administration expenses to charity, and it is inconceivable that anyone should claim that she intended to give the amount of her taxes to charity, yet they are equally obligations which must be discharged before the charitable bequests are satisfied. Doubtless the law intended to favor charitable bequests by allowing the amount of such bequests as a deduction from estates.

The tax, however, is in no sense on the charities. It is on the estate, and if, as a matter of fact, it diminishes the share which goes to charity, that is something for which the testatrix and not the law is responsible. She can always protect the charities by giving them general legacies and leaving the residuary to individuals. The charities will then always receive the legacies free and clear of the Federal estate tax. In the case at bar the charities, owing to the enactment of Section 403, Subsection (a) (3), almost four months after the testatrix's death, will receive nearly $8,000,000 more than the testatrix could have expected they would receive. At the time of her death charitable bequests were not deductible, and the tax, if assessed under the law as it existed at that time, would have been approximately $10,000,000. But however that may be, the will and not the statute is the measure of the testatrix's bounty. She and her able counsel knew the law and the well-established meaning of terms like rest, residue, and remainder, and residuary estate, and the meaning of these words should not be upset in order that certain charities shall obtain several million dollars more than she contemplated at the time she made her will.

The correctness of the contention that the Federal estate tax is part of the amount of the residuary bequest to charity may be tested by considering the converse of the case at bar. If Congress in pursuing a mortmain policy had provided that the amount of all bequests to charity should be taxed at a higher

rate than other bequests, would the Government be permitted to compute the amount of a residuary bequest to charity for the purpose of imposing a higher tax without subtracting the amount of the Federal estate tax? Would it not shock the conscience of the court if a claim should be made that the Government could increase its tax by including in the amount of the residuary bequest to charity a sum no part of which ever could be, or was, given to charity and no part of which the residuary legatee could ever receive? Such an illustration simplifies the problem and strengthens the contention that the meaning of the well-known term residuary estate should not be construed as depending upon the purpose to which that estate is to be devoted, or the rate of taxes thereon, or the exemption of that estate from any tax.

Taxes are concrete realities, not philosophical abstractions. So are residuary estates. And when Congress provides that, in fixing the net estate for purposes of taxation, the amount of bequests to charity should be deducted and the bequest takes the form of the residuary estate, the residuary estate should be held to mean the amount which the beneficiary will receive after prior charges payable therefrom shall have been made.

That amount is one which can readily be computed by any accountant competent to keep the books of a forty-nine million dollar estate. Neither the method nor the accuracy of the computation, as made by the

Commissioner of Internal Revenue, is attacked in the complaint, so the consideration of mere mathematical computations is not involved. If the Federal tax is a part of the residuary estate, then the executors are right and the judgment should be affirmed. If they are not, the Commissioner of Internal Revenue was right and the judgment should be reversed.

CONCLUSION.

The judgment of the court below should be reversed.

JAMES M. BECK,
Solicitor General.
ALFRED A. WHEAT,
Special Assistant to the Attorney General.
DECEMBER, 1923.

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